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UNCLAS SECTION 01 OF 04 OTTAWA 002078

SIPDIS

SENSITIVE

DEPT FOR WHA (DAS JEWELL), WHA/CAN (HOLST) AND INR (SALCEDO)

USDOC FOR 4310/MAC/ONA

E.O. 12958: N/A

TAGS: [ECON](#) [SOCI](#) [EFIN](#) [PGOV](#) [CA](#)

SUBJECT: U.S.-CANADA ENERGY CONSULTATIVE MECHANISM:  
SCENE-SETTER

REF:

SUMMARY/INTRODUCTION

1. (U) Sensitive, but unclassified. Not for distribution outside USG channels.

2. (U) Canada is the United States' largest foreign supplier of energy, and (when its oil sands are considered) the world's second largest holder of petroleum reserves. While high energy prices are boosting Canada's export values and stock markets, they also hurt Canadian consumers, who use significantly more energy per capita than Americans. Canadian energy policymakers face many of the same problems as their U.S. counterparts: declining conventional oil production; tightening natural gas supplies; policy/regulatory decisions on northern natural gas pipeline developments; a need for more investment in the electrical transmission grid; formation of an electrical reliability organization; pressure to reduce greenhouse gas emissions; a desire to exploit new energy technologies; and how to respond to Chinese investor interest in oil resources.

3. (U) Canadians also face some more country-specific problems of long standing, including how best to encourage development of frontier resources (in oil sands, the Atlantic offshore, and the North where natives are key stakeholders); and whether to try to diversify its trade away from the United States, which is currently the destination for virtually all of Canada's energy exports.  
END SUMMARY/INTRODUCTION.

THE WORLD'S LARGEST ENERGY PARTNERSHIP

4. (SBU) Energy exports are vital to Canada's economy. Oil, gas and petroleum products accounted for 18 percent of Canada's total exports to the United States, and 15 percent of Canada's total exports worldwide, in 2004. The value of Canada's energy exports - which also include electric power, coal and uranium - was over US\$ 50 billion last year. Partly due to its cold climate and resource-intensive industries, Canada's economy is intensively energy-consuming: on a per capita basis, Canadians used over 23 percent more energy than Americans in 2002.

5. (SBU) The U.S.-Canada energy relationship is unique in the world, in both the sheer size of bilateral energy trade and the very high level of integration and coordination. The August 2003 power outage and the collaborative investigation that resulted highlight this interdependency, as well as the need to synchronize or coordinate the regulatory environment and electricity reliability standards. A wide range of other energy issues demand similarly close bilateral coordination.

6. (SBU) The Security and Prosperity Partnership announced by the three North American leaders in March 2005 has started or invigorated cross-border initiatives in many areas, including energy. For example, on June 27 Ministers announced a trilateral gas initiative to address a range of issues related to the natural gas market in North America, such as the transparency of regulations, laws and site selection processes in the three countries. We also established a regulators' expert group to improve communication and cooperation on matters before FERC, Canada's National Energy Board, and Mexico's Comision Reguladora de Energia.

OIL AND OILSANDS

7. (U) Canadian production of crude oil currently stands

at about 2.5 million barrels per day. In 2004 Canada exported an average of more than 1.6 million bpd, nearly all of it to the United States. At the same time, because Canadian consumers tend to live far from most of Canada's oil producing regions, eastern Canada imports some 1.5 million bpd, including some from the United States.

18. (SBU) The vast resources of Alberta's oil sands constitute proven petroleum reserves greater than in any country except Saudi Arabia, with 175 billion barrels (the rest of Canada's proven reserves are around five billion barrels, and declining). The oil sands could hold as much as 315 billion barrels of ultimately recoverable petroleum. Oil sands production now exceeds one million barrels per day and is growing strongly due to massive capital investment. American awareness of the oil sands has heightened in recent years, and Treasury Secretary Snow visited the region in early July 2005.

19. (SBU) There are significant constraints on development in the oil sands, including high labor costs, high water usage, lack of pipeline and refinery capacity, high energy inputs (particularly of natural gas) and high greenhouse gas emissions. Producers are working on all fronts to address these issues, and high oil prices give them the margins to do so.

110. (SBU) Production of oil from beneath the continental shelf off Newfoundland began in the late 1990's, and daily oil production there exceeds 200,000 barrels. Offshore production in the Arctic (Beaufort Sea) awaits construction of the Mackenzie pipeline project (see below), while development on the Pacific coast is currently blocked by federal and provincial moratoria on drilling.

#### NATURAL GAS -----

111. (SBU) Natural gas production in Canada in 2004 totaled about six trillion cubic feet (TCF), or around 17 billion cubic feet per day (BCF/D), of which about 55 percent was exported to the United States by pipeline. Canadian gas accounts for more than 15 percent of U.S. natural gas consumption. However, compared to its very high production rate, Canada's proven natural gas reserves, at about 56 TCF, are relatively small and have been declining since 1996. As with oil, one new area that has opened up in recent years is the Atlantic offshore, where about 200 BCF per year is being produced, mostly for export by pipeline to New England.

112. (SBU) The next major new supply to enter the Canadian market will likely be gas from the Mackenzie Delta and Beaufort Sea area in the Northwest Territories, which is expected to be brought to market when the proposed Mackenzie Gas Project begins delivering around 2010. The area in question contains about 9 TCF in proven reserves and up to 61 TCF ultimate potential. The regulatory and permitting process for this pipeline is proceeding, but has been delayed by difficult negotiations mainly involving the Deh Cho natives in the southern part of the Mackenzie River valley. Currently, a deal involving the GOC, the territorial Government and the Deh Cho appears to have been reached but has not been finalized.

113. (SBU) North America's natural gas market is now substantially disconnected from those on other continents, but this will change if major new liquefied natural gas (LNG) infrastructure - including specialized port facilities and ships - is built. In Saint John, New Brunswick, the Irving Oil Company has begun construction on an LNG port, and there are less advanced proposals for facilities in Nova Scotia and near Quebec City.

#### ELECTRIC POWER -----

114. (SBU) Our two countries' electric power grids are closely connected - trading some 50 billion kilowatt-hours in both directions each year, and sharing the effects of the August 2003 Northeast power outage. Nevertheless, most of the Canadian grid was developed by provincial government-owned monopoly utilities, and this heritage continues to be revealed by a relative shortage of inter-provincial and cross-border links.

115. (SBU) Canada's net exports of electric power to the United States have declined steeply over the past decade, due to growing demand and a lack of investment in new generating capacity. Manitoba, which has major

undeveloped hydroelectric generating sites, advocates government-led investment in an east-west transmission line to distribute its power to Ontario and elsewhere. Newfoundland and Labrador also has major undeveloped hydro capacity, but has been unable to negotiate an agreement with Quebec to transmit this power to market.

16. (SBU) Ontario has made a commitment to shut its coal-fired generating plants. While it is re-starting some aging nuclear units, and planning for new gas-fired and renewable generation, it continues to be severely challenged to close its supply gap. This could open up opportunities for U.S. players, either in constructing new capacity within Ontario, or in exporting power to the province. In the short term, a strike by managers and engineers, combined with high hot-weather demand, is putting Ontario's grid under real strain this summer.

17. (SBU) Canadian players support U.S. steps toward mandatory electrical reliability standards, including creation of an Electric Reliability Organization, and toward facilitating investment in electrical grid infrastructure. The Canadian Electricity Association views the recent progress of U.S. energy legislation as being positive for this industry.

#### NUCLEAR ISSUES

18. (SBU) Canada is the world's largest uranium producer. One Canadian company, Cameco, supplies half the U.S. uranium market and about 20 percent of the market worldwide. Nuclear power accounts for about 13 percent of electricity generation in Canada, with 20 of the country's 22 electricity-producing reactors located in Ontario. All of these reactors are of the Canadian-developed "Candu" design, cooled and moderated by heavy water. Efforts to license the newest version of the Candu, the Advanced Candu Reactor (ACR), in the United States were set back during the past year when a U.S. private sector partner withdrew. The ACR uses slightly enriched uranium as fuel, and attempts to limit the spread of enrichment technology could hamper efforts to sell the reactors worldwide.

19. (SBU) Canada does not have a national nuclear waste repository. Most nuclear waste is stored at reactor sites. The Nuclear Waste Management Organization, created in 2002, is studying various alternatives and is expected to issue a recommendation in November 2005. Discussion reports are available at website [nwmo.ca](http://nwmo.ca).

#### CLIMATE CHANGE

20. (SBU) Canada formally ratified the Kyoto Accord at the end of 2002, despite vocal criticism from provincial governments and industries. Critics have been concerned that the burden of compliance would fall disproportionately on certain regions and industries, and also that compliance would place Canada's economy at a lasting competitive disadvantage vis--vis the United States.

21. (SBU) In April 2005, Canada announced its long-awaited strategy to meet its greenhouse gas emission reduction commitments under the Kyoto Protocol. Most players acknowledge that Canada's Kyoto target (emissions six percent below 1990 levels by 2012) is no longer

attainable, if it ever was. The need to maintain a competitive industry environment vis--vis the United States was a major constraint in crafting the plan, but the GOC touts the economic, technological and environmental benefits of reducing emissions.

22. (SBU) FULL TEXT OF THE STRATEGY IS AVAILABLE AT WEBSITE [CLIMATECHANGE.GC.CA](http://CLIMATECHANGE.GC.CA). EXPERTS HAVE EXPRESSED DISAPPOINTMENT AT THE LACK OF DETAIL, PARTICULARLY GIVEN THAT THIS POLICY HAS BEEN UNDER DEVELOPMENT THROUGHOUT THE GOVERNING LIBERAL PARTY'S ELEVEN-PLUS YEARS IN POWER. PRESS AND SOME POLITICIANS ARE CRITICAL OF THE PROSPECT OF BUYING EMISSION CREDITS FROM ABROAD (TRADING "TAXPAYER DOLLARS FOR THIN AIR") AND ALLEGE THAT THE PLAN PUTS MORE BURDEN ON INDIVIDUALS AND HOUSEHOLDS THAN ON INDUSTRY.

23. (SBU) While our political approaches to the climate change issue have differed, practical U.S.-Canada cooperation on this issue has been close. In 2002, the two governments signed agreements on Renewable Energy and

Climate Science, and formed a bilateral Working Group on Climate Change. Canada participates in the U.S.-led, international Carbon Sequestration Leadership Forum, which researches effective ways to capture and store carbon dioxide. Canada is also a founding member of the

International Partnership for the Hydrogen Economy and the Global Earth Observation System of Systems, both of which are U.S. international initiatives designed to address climate change. In early 2005, Canada joined the U.S.-led international initiative, Methane to Markets, which focuses on transferring technology to developing countries for the capture and use of methane from pipelines, landfills and other sources.

WILKINS